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B-To-B Aggregators -- Vertical Domination -- Vertical Aggregators Have More Than Turned A Few Heads. Now They're Poised To Dominate B-To-B E-Commerce. Can They Pull It Off?

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Online marketplaces have won financial backing from venture capitalists and investment banks, and some have even made money. Now, these Internet intermediaries need to deliver on their promise of more efficient e-commerce before they're in a position to dominate vertical industry markets.

Leading portal sites Chemdex and VerticalNet are the early prototypes for e-market businesses: sites that aggregate buyers and sellers online, and also solve problems of **information** and catalog aggregation. Chemdex offers an exchange for products and **information** specific to the life sciences industry, and VerticalNet provides news, original content and competitive product **information** to more than 50 vertical industry segments, from wastewater to food service to machine tools. Soon, Chemdex will expand into other vertical markets, starting with medical supplies, and VerticalNet will add transactions to its many portal sites, starting with electronics components exchange NECX, which it acquired late last year.

Chemdex makes money by providing value to buyers who use its site to locate and buy products. Martha Greer, the company's vice president of marketing, estimates that it costs on average $100 for buyers to create a purchase order. Most of that cost is in the time it takes for highly skilled technicians to search for and find the right antibody or **chemical** compound in paper catalogs. Chemdex has assembled 1.2 million products in a way that lets users search for complex products by multiple attributes. By reducing search time, the company cuts purchase order costs to $10 or $20 per requisition, making it cheaper, faster and easier to buy online.

All well and good. But what makes Chemdex anything more than a better storefront for physical distributor and partner VWR Scientific Products? And, is VerticalNet anything more than an online media company with a $9 billion market cap? Industry experts agree that the potential dynamics of this breed of online marketplace do justify their valuations, and that, in the long run, aggregation technologies may upend how businesses buy and sell products.

"If any of these companies live up to their promise, they're undervalued, not overvalued. The catch is, which one of these companies will live up to its promise?" says Ted Rybeck, chairman of Benchmarking Partners, Cambridge, Mass. Benchmarking Partners advised Internet Capital Group in its investment strategy, which includes investing in more than 40 companies. Some of its investments are Commerx, Onvia.com, Arbinet, Bidcom, VerticalNet and ClearCommerce.

Right now, the market is ripe for a shakeout. The enthusiasm of investment banks and venture capital firms led to a tenfold increase of e-marketplace players, jumping from 30 to 300 last year. And not all of them have clear value propositions for their vertical industries. For example, there are two dozen business-to-business e-marketplaces in the construction industry, each hoping to capture some portion of the $650 billion-a-year market. The catch is that, so far, the purchasers in this space-subcontractors-have yet to show any need or inclination to buy over the Internet.

The promise for these e-marketplaces to be big money makers stems from the dynamics of hooking large suppliers and buyers into an online intermediary. Once connected, a company can communicate purchase orders, transaction and fulfillment **information** across the Internet, often replacing inefficient paper-based systems and thereby saving money.

The great hope is that once a critical mass of buyers and sellers has been reached and transactions are flowing through its system, no other marketplace can compete for that vertical industry. If that's true, the first to conquer a vertical industry by providing significant value will own that **market segment** and has a shot at taking a percentage of every transaction that flows through it.

"It's a winner-takes-most scenario because of the switching costs that are built into using the system,'' says Chemdex's Greer. "Once you have trading partners working together and you can own that vertical market, you have incredible value over time, she says, adding that "investors are willing to bet on the winning company; not even the No. 3 player can return any value to its market.''

The challenge for these e-marketplaces is to find value propositions unique to each industry vertical and be aware of the businesses already in the space. Powerful suppliers, distributors and resellers can lock up an industry and make it impossible for an intermediary to gain any traction.

Two Main Factors

Leah Knight, senior industry analyst at consultancy Gartner Group, says the business-to-business world is defined by two factors: The first is a power play, because, with different industry dynamics, the power goes to either the **supplier** , buyer or channel. Second, there are pre-existing relationships that need to be taken into account. For example, is the e-marketplace going to replace that pre-existing channel or support it?

For the moment, brick-and-mortar companies are largely unthreatened by the niches vertical portals now occupy. Through content aggregation, these new online intermediaries offer value-added services that haven't existed before. Companies like Chemdex offer value over paper-based processes, and they're helping large companies streamline their purchase of nonessential goods and services. Technology providers like ChannelPoint, Colorado Springs, Colo., are hand in glove with the large companies, taking what they can get from corporate IT budgets, instead of boldly reinventing commerce, Internet style, and conquering broad markets with superior technology.

Owning the portal is one strategy for large insurance companies like Aetna and United Healthcare. Using ChannelPoint's technology and services, Aetna and United Healthcare outsourced the development of private portals that they'll use to communicate more efficiently with thousands of brokers throughout the United States. That distributed, or fragmented, group of people is the main channel for selling health and life insurance plans to businesses.

What benefits do large insurance companies gain by training their distribution channel to work through a portal? They benefit from a cost savings in paper and shipping required to communicate rate plans, policy changes and competitive **information** to brokers. They also give brokers access to tools and **information** to sell competitive products. Certainly, the portal service cuts costs, improves productivity and helps brokers give better service to end customers-corporate HR departments.

"It used to take United Healthcare three to five days to turn around a proposal to a broker. Now they can do it in less than 19 minutes. It used to take them 45 to 90 days between when they received enrollment applications to when they were able to issue cards. Now it takes them less than five days," says Mitch Bishop, vice president of corporate marketing, at ChannelPoint.

In this model, large companies are getting the advantage of a communications "e-frastructure.'' Whether or not those alliances will tie buyers and suppliers into a cost center hasn't been proven yet in practice.

VerticalNet is building sites that strive to bind the audience to it as closely as possible so users can't make a purchasing decision without first consulting the vertical portal. Toward this end, VerticalNet assembled services similar to those on consumer or retail sites, such as

community chat and discussion groups, job boards and original content. Then it adds a healthy dose of original, industry-specific content, competitive product **information** , and RFQ and RFP management to clinch the deal. So far, the company estimates it has captured an audience of 2.5 million, with a net spending power in the millions of dollars.

"There's a lot of money to be made through the periphery of services around the flow of commerce,'' says Mike Hagan, co-founder, executive vice president and chief operating officer of VerticalNet, Horsham, Pa. "When you create an exchange, you can also create services around what buyers are looking for online, and bundled services like credit risk management. Those are some of the key hypergrowth drivers you're going to see.''

Market research group Forrester Research says that to attain the massive increase in transaction volume e-marketplaces are working toward, they have to add services and multiple transaction mechanisms. Today, about half of e-marketplaces offer credit and payment services, links to distribution and logistics scheduling, integration with ERP and financial data, and transaction settlement services. More than 80 percent of e-marketplaces plan to deploy all those services by 2001, according to Forrester.

Marketplaces are not just growing within vertical industries. Some sites specialize in offering value-added services across multiple industries, helping companies solve problems not essential to production processes. Services and sites can be linked together on the Web: horizontal to horizontal, vertical to vertical or, most often, vertical to horizontal.

Transaction settlement and credit sites like eCredit.com, e-Escrow and escrow.com have a wide variety of partner relationships that foster transactions across consumer, retail, business-to-business and private portal sites. Creating a **network** of intertwining Web sites and services gives hubs a wide reach into different business communities, which they can leverage to aggregate hard-to-sell products-like a used backhoe-and shop them across industries, geographies and market segments. But tracking the spreading matrix of services can be tough, as every success story has plans that include growing out of its niche.

"Vertical and horizontal are still meaningful terms, but you have to put an asterisk by those words anytime you use them, because everybody wants to have a play at being in both places,'' says Tim Clark, a vice president at Net Market Makers, a consultancy in Berkeley, Calif.

As portal sites expand their services, they create a more efficient commerce infrastructure. Businesses may find themselves transacting more through these combined hubs. But how do large businesses feel about putting their business-critical transactions on the Internet? Benchmarking Partners' Rybeck says getting over that trust barrier will drive phase two of the e-commerce revolution: direct procurement online. It involves getting businesses to buy the materials used in the direct production of their products-the tires and belts for a General Motors car, for instance.

Other Plans

But General Motors has other plans. In the past few weeks, Chevron, GM, DuPont and other large suppliers have allied themselves with two main technology providers-Commerce One and Ariba-to build their own portal sites to connect them to their trading partners and streamline indirect procurement. It's still not clear how these sites will compete with independent e-marketplaces. But what is clear is that technology acumen, which gave Chemdex an early lead in catalog aggregation is moving closer to becoming a commodity and becoming less of a competitive differentiator or a barrier to entry.

Ariba and Commerce One have used their giant market valuations to buy complementary products and technologies. Ariba bought trading platform companies, and Commerce One acquired XML and search technologies.

Those companies' strategies to aggregate the technology components of an e-marketplace will make it easier for traditional brick-and-mortar companies to get online and launch vertical portals quickly. However, every new entrant into the portal game will have to do the tough work of building a user audience, aggregating products and building a common data platform among trading partners.

The effort businesses make in the early part of the evolutionary

cycle may determine which companies survive. Portals are a cheap, cost-cutting way for buyers and suppliers to find one another and conduct trades. But businesses are realizing that participating in an e-marketplace may change their relationships with trading partners, suppliers and customers. So the question remains: The vertical aggregators have made quite a splash, but can they dominate e-commerce?

With the Gartner Group estimating that e-marketplaces will account for 37 percent of the $7.3 trillion business-to-business e-commerce market by 2004, the aggregators are well on their way.

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COMPANY NAMES: VerticalNet--Management; Chemdex Corp.--Management
GEOGRAPHIC CODES/NAMES: 1USA United States
DESCRIPTORS: Industry trend; Electronic commerce
EVENT CODES/NAMES: 600 Market **information** - general;010 Forecasts, trends, outlooks
PRODUCT/INDUSTRY NAMES: 7372418 (Industry-Specific Software)
NAICS CODES: 51121 Software Publishers
FILE SEGMENT: CD File 275
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